

Chapter 9 Contents

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**SECTION 1
DIFFERENCE BETWEEN AUDITING AND ACCOUNTING**

A) AUDITING

Auditing is a set of procedures performed to enable an auditor to express an opinion as to whether the financial statements present the financial information fairly, in all material respects, in conformity with generally accepted accounting principles as established by the American Institute of Certified Public Accountants (AICPA).

B) ACCOUNTING

Accounting is the process of identifying, recording, classifying and reporting information on economic events in a logical manner for the purpose of providing financial information for decision making.

**SECTION 2
AUDIT REQUIREMENT**

A) REQUIREMENT

Michigan Public Act 2 of 1968, as amended, requires that each governmental unit serving a population of 4,000 or more have an annual audit (those under 4,000 must have an audit every other year). Refer to MCL 141.433 Sec. 5. Other non-governmental libraries are subject to audits as required by governing bylaws or other authoritative documents.

Audits are performed in accordance with Generally Accepted Auditing Standards. Libraries that receive federal funding may also require a program-specific audit or an OMB Circular A-133 audit (Single Audit). See Section 3, Types of Audits/Audit Process for further discussion.

Benefits of an audit include credibility of financial statements, professional guidance in preparing useful financial statements, advice on developing and maintaining internal controls and assistance with compliance requirements.

B) DISTRIBUTION

Independent audit reports for government libraries are considered public records to be distributed upon request. Typically they are distributed as follows:

- Library board and/or audit committee
- State of Michigan Local Audit and Finance Division of the Department of Treasury
- The Library of Michigan (when a Single Audit is required under LSTA guidelines)
- Federal Audit Clearinghouse (if a Single Audit or program audit is required)
- Lenders

SECTION 3 TYPES OF AUDITS/AUDIT PROCESS

A) FINANCIAL STATEMENT AUDIT

Financial statement audits provide reasonable assurance about whether financial statements present fairly the financial position and results of operations in conformity with generally accepted accounting principles.

Components of a financial statement audit include the following:

- Consideration of the library's internal controls
- An examination of evidence supporting the amounts and disclosures in the financial statements
- An opinion expressed regarding whether the financial statements are free of material misstatement

B) PROGRAM-SPECIFIC AUDIT

Program audits for libraries are not very common but might be required for certain programs. Auditing requirements are stipulated in grant agreements.

Program audits include determining the following:

- Extent to which desired results or benefits established by the legislature or other authorizing body is being achieved.
- Effectiveness of organizations' programs, activities or functions.
- Compliance with significant laws and regulations applicable to the program.

C) OMB CIRCULAR A-133 AUDIT (SINGLE AUDIT)

Single Audits include the following:

- Perform an audit of the financial statement and schedule of expenditures of federal awards in accordance with Government Auditing Standards as prescribed in the "Yellow Book."
- Determine whether the schedule of expenditures of federal awards is presented fairly in relation to the financial statements as a whole.
- For "major programs" (determined using a prescribed, risk-based approach), obtain an understanding of internal controls relating to the compliance requirements established for the program, assess control risk and perform test of controls.
- Determine whether the library has complied with provisions of laws, regulations, contracts and grants.
- Issue report letters regarding the library's compliance with laws and regulations and internal controls related to the financial statements and major federal awards.

See Exhibit 9-1 for a chart for determining the applicability of a Single Audit.

SECTION 4 SELECTION OF AN INDEPENDENT AUDITOR

A) ESTABLISHING AN AUDIT POLICY

Library boards should develop a policy as to the type of professional relationship the library will have with its independent auditor. Some boards desire long-term relationships, while other boards believe it is appropriate to change independent audit firms every few years.

B) IDENTIFYING POTENTIAL AUDITORS

There are a number of methods for identifying potential audit firms. Referrals are often the best source. Ask for recommendations from board members, attorneys, bankers or contacts from other library organizations.

C) METHODS FOR OBTAINING QUOTES FOR PROFESSIONAL SERVICES

Methods for obtaining quotes for professional services, including audits, vary among library organizations and depend on the procurement policies of the organization. Many government and not-for-profit organizations use a request for proposal (RFP) process to obtain quotes.

RFP documents state the audit requirements, period to be covered, library contact person and method for questions to be answered or information to be obtained.

RFP documents request information including, qualifications of an audit firm, qualifications of staff to be assigned to the engagement, audit approach, references and fees.

See Exhibit 9-2 for a sample RFP document.

D) CRITERIA FOR SELECTION

Selection of a Certified Public Accountant (CPA) should be based on reputation, expertise and willingness to serve your organization. The decision-making body should develop preliminary criteria at the start of the selection process. Identification of the criteria most important to the library would also be appropriate. This information can be used to evaluate a single proposal or to evaluate and compare multiple proposals.

Criteria for selecting an auditor may include the following:

- Background of the staff to be assigned to the engagement
 - Staff experienced in accounting and auditing libraries.
 - Personal abilities of engagement staff (perceived ability to relate and work well with library staff).
- Ability of CPA to respond quickly, effectively and competently to the library's needs
 - Ability of CPA firm to complete audit by library's deadline
 - Willingness to provide recommendations for improving internal controls and financial management practices
 - Ability of engagement staff to access other resources a library may need (specialists, consultants, reference materials, etc.)
 - Overall attitude with which CPA approaches client service

- Reputation
 - How others in and outside the library field perceive the CPA
 - Involvement of staff in library professional activities
 - Commitment to serving libraries
- Fee
 - Single year or multi-year contract (library should stipulate needs)
 - Should not be the deciding criterion unless two or more firms are perceived equal in all other areas
 - CPAs that propose fees that are significantly lower than other CPA's may not be realistic about the effort required to complete the audit or are "low-balling" to get the work. In these cases, question the CPA about the basis for the fee quoted.
- Continuity of staff assigned to the engagement
 - Some level of staff turnover is likely; excessive turnover is not desirable
 - Some organizations believe planned rotation of staff is desirable as a means to bring new ideas to the engagement process.

SECTION 5 PREPARATION FOR AN AUDIT

A) HOW YOU CAN ASSIST

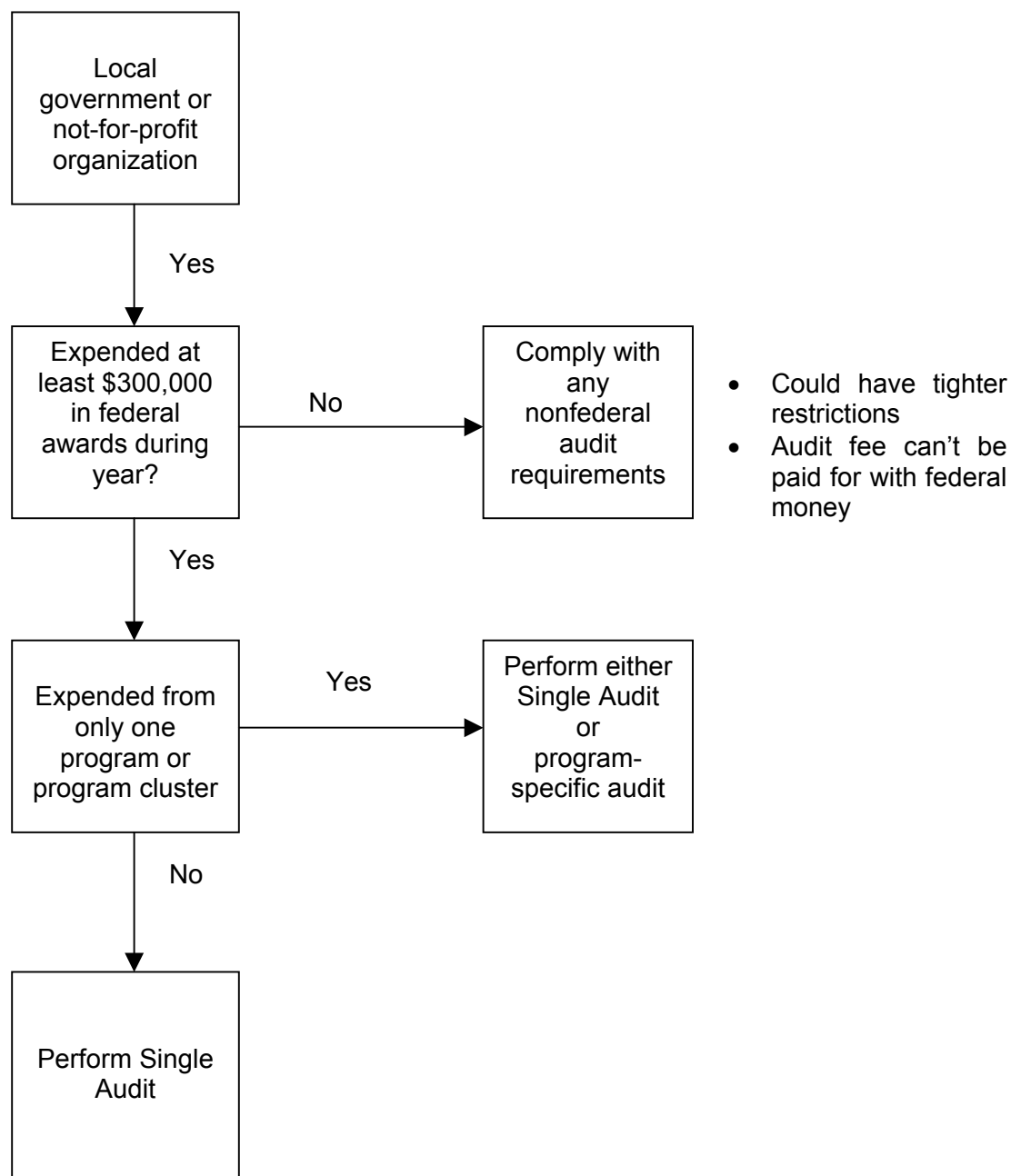
Following are considerations for preparing for an audit:

- Communicate throughout the year with the auditors regarding unusual or difficult accounting issues and library activities, in general
- Implement and maintain sound internal control procedures (refer to Internal Controls chapter)
- Maintain appropriate accounting and financial documentation
 - Current trial balances
 - Ongoing account analysis schedules
 - Interfund transactions balance
 - Balance sheet accounts agree to detail records
 - ◆ Bank reconciliations
 - ◆ Accounts receivable detail
 - ◆ Taxes receivable
 - ◆ Accounts payable detail
 - Filing of invoices and other accounting records
 - Maintain an audit trail
 - Maintain comprehensive "files" for key items
 - ◆ Headlee (see Property Taxes chapter)
 - ◆ Budget adoption/amendments
 - ◆ Debt information
- Prepare confirmation reports
 - Auditor must control the process including mailing the confirmations
 - You can follow up with phone calls for nonresponses
- Prepare schedules requested by auditor
- Pull samples selected by the auditor
- Prepare financial statements

B) TIMING OF AUDIT AND ASSISTANCE

- Meet/discuss with audit partner/in-charge before year-end regarding their audit approach
 - Will they document accounting system before year-end
 - Will they test transactions before year-end
 - What confirmations can be prepared ahead of time
 - What accounts will they want to analyze
 - Communicate with auditors when books will be “closed” (transactions have been recorded, adjusting journal entries have been made and a preliminary trial balance is available)
 - Identify a preliminary timetable for audit start and completion dates
 - Communicate rules regarding use of phones, photocopies and files
- Before the auditors arrive and before year-end
 - Provide work space. Consider access to phones, photocopier and files
 - Prepare confirmation requests
 - Start on analysis of key accounts identified by auditor
- After year-end
 - Complete analysis of key accounts and agree to general ledger balances
 - Agree balance sheet supporting detail to general ledger balances
 - Review general ledger for unusual account balances and investigate
 - Make all minor adjustments before finalizing general ledger
- When the Auditors arrive
 - Assign an individual (focal person) (e.g. to pull samples, make photocopies, etc.)
 - Monitor the audit progress
- After the audit is complete meet/discuss with auditors the results of the audit
 - Problem areas
 - Journal entries
 - Identify strengths of the library
 - Identify areas of improvement for the library
 - Provide feedback to auditors regarding their performance

EXHIBIT 9-1
DETERMINATION OF APPLICABILITY OF A SINGLE AUDIT



**EXHIBIT 9-2
REQUEST FOR PROPOSAL
AUDIT SERVICES**

NOTICE OF PROPOSAL

The _____ is issuing this request for proposal (RFP) for the financial audit of the Library's financial statements (if necessary, and a compliance audit of the federal programs in accordance with the Single Audit Act. The contact person regarding this RFP is _____ and can be reached at the _____, _____. The response due date for this RFP is _____ PM, _____. Any proposals received after this date will not be considered. We are requesting only _____ copies of your proposal in a sealed envelope. The envelope should clearly indicate it is a proposal for audit services. The audit period under contract is for the year(s) ended _____, _____ and may be extended at the discretion of Library.

AUDITING STANDARDS

Your examination will be conducted in accordance with the standards for financial audits contained in Audits of State and Local Governments, and if necessary compliance audits contained in the Standards for Audit of Governmental Organizations, Programs, Activities and Functions, issued by the U.S. General Accounting Office, the Single Audit Act and, accordingly, will include any other tests of the accounting records and such other auditing procedures you consider necessary in the circumstances, including the requirements of Public Act 2 of 1968 as amended.

MANDATORY QUALIFICATIONS OF THE AUDITOR

The following information must be affirmed in the proposal response:

1. The proposer is properly licensed for public practice as a Certified Public Accountant.
2. The proposer meets the independence requirements of the Standards for Audit of Governmental Organizations, Programs, Activities and Functions published by the U.S. General Accounting Office.
3. The proposer does not have a record of substandard audit work. Please disclose the controls your firm has in place to ensure quality standards have been met. Also, disclose whether your firm is subject to an external quality control review process.

MONITORING

To ensure the quality of the audit, the Library may request, from time to time, a report on the progress of the audit. In addition, prior to completion of the fieldwork, an audit exit conference will be held to discuss the results of the audit.

TIME REQUIREMENTS

The Library shall receive all proposal responses by _____ PM _____.
We anticipate the successful bidder will be notified by _____.

EXHIBIT 9-2
REQUEST FOR PROPOSAL
AUDIT SERVICES, continued

WORKING PAPERS

The working papers shall be retained for at least three years. The working papers will be available for examination by authorized representatives of the State of Michigan, and, if required the cognizant federal audit agency and the General Accounting Office.

RIGHT TO REJECT

The Library reserves the right to reject any and all proposals submitted and to request additional information from all proposers. Any contract awarded will be made to the independent auditor who, based on evaluation of all responses, applying all criteria and oral interviews if necessary, is determined to be the best qualified to do the audit.

NUMBER OF COPIES OF AUDITOR'S REPORTS

The auditor shall furnish the Library ____ copies of all required reports. In addition, the auditor shall furnish the requested number of copies to each federal and state agency, as applicable.

CONTRACTUAL ARRANGEMENTS

Invoices for service will be paid when received. The total amount to be invoiced shall not exceed the amount of the bid unless other arrangements have been negotiated with the Library first. The cost of audits for subsequent years will be negotiated each year. The Library reserves the right to terminate the contract for audit at any time.

METHOD OF EVALUATING PROPOSALS

Proposals will be evaluated with a strict emphasis on quality. Attributes, which will be analyzed, include:

Evaluation Worksheet

1. Number of governmental entities audited by office of CPA firm proposing.
2. Firm governmental resources available.
3. Involvement in governmental activity and organizations.
4. Training of personnel in governmental (and federal grant) auditing.
5. Quality of staff included in assignment.
6. Reference responses.
7. Internal quality control procedures and external quality control review.

After technical qualities have been evaluated, cost and other considerations will be evaluated. The proposing audit firm should indicate the cost of the audit for the first year and the range or average cost per hour for audit services. Once all factors have been evaluated, the audit firm who is most qualified and reasonable in cost will be selected.

EXHIBIT 9-2
REQUEST FOR PROPOSAL
AUDIT SERVICES, continued

FORMAT OF THE RFP RESPONSE

It is suggested the RFP response be formatted as follows:

Title Page

The response should identify the RFP subject and the name of the independent auditor, local address, telephone number, name and title of contact person and date of submission. The period which the proposal is effective should also be disclosed.

Table of Contents

The table of contents of the proposal should include a clear and completed identification of the materials submitted by section and page number.

Letter of Transmittal

The letter of transmittal should contain the following information:

- A brief understanding of the audit service to be performed
- A positive commitment to perform the service timely.
- The names of persons authorized to represent the proposer, their title, address and telephone number. This may be important if different from the individual who signs the transmittal letter.

PROFILE OF THE INDEPENDENT AUDITOR

The proposers are requested to provide a profile of general background information. This should include:

1. The organization and size of the proposer, whether it is local, regional, national or international in operations.
2. The location of the office from which the work is to be done and the number of professional staff by staff level employed at that office.
3. A description of the range of activities performed by the local office such as auditing, accounting, tax service or management services.
4. A statement on the proposer's staff capability to audit federal programs, including the number and classifications of personnel skilled in federal program auditing who will work in the audit, if required to.
5. A positive statement that the following mandatory criteria are satisfied:
 - A. An affirmation that the proposer is properly licensed for practice as a certified public accountant.

EXHIBIT 9-2
REQUEST FOR PROPOSAL
AUDIT SERVICES, continued

- B. An affirmation that the proposer meets the independence requirements of the Standards for Audit of Governmental Organizations, Programs, Activities and Function, published by the U.S. General Accounting Office.
- C. An affirmation that the proposer does not have a record of substandard work.
- D. An affirmation from the proposers that they will follow the American Institute of Certified Public Accountants' (AICPA) "Interpretation 501-3, Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits." Basically, if a member of the AICPA accepts such an engagement and undertakes an obligation to follow specified the government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, the auditor is obligated to follow such requirements. Otherwise, the auditor must disclose in the audit report the fact that such requirements were not followed and the reasons therefor.

SUMMARY OF THE PROPOSER'S QUALIFICATIONS

- 1. Identify the audit managers, field supervisors, and other staff who will work on the audit, including staff from other than the local office. Resumes including relevant experience and continuing education for auditor in-charge up to the individual with final responsibility for the engagement should be included. (The resumes may be included as an appendix.)
- 2. Describe the recent local and regional office auditing experience similar to the type of audit requested and give the names and telephone numbers of client officials responsible for three of the audits listed.
- 3. Other auditors who are participating in the audit are also required to provide similar information.

PROPOSER'S APPROACH TO THE EXAMINATION

Submit a work plan to accomplish the scope of the audit. The work plan should include time estimates for each significant segment of the work and the staff level to be assigned. Where possible, individual staff members should be named and their titles provided. The planned use of specialists should be specified.

The audit work plan should completely cover what audit work will be accomplished to allow the auditor to render:

- 1. A report on the study and evaluation and report on internal control systems.
- 2. Reporting on the organization's control system to assure compliance and whether the organization has complied with laws and regulations that may have an effect on each major federal assistance program.

The audit work plan should demonstrate the auditor's understanding of the audit requirements of a single audit as specified in OMB Circular A-133 and the audit tests and procedures to be applied in completing the audit plan.

**EXHIBIT 9-2
REQUEST FOR PROPOSAL
AUDIT SERVICES, continued**

TIME REQUIREMENTS

If not already adequately covered in the letter of transmittal, the response should detail information on when the audit firm plans to deliver the final reports.

COMPENSATION

Provide a not-to-exceed cost of services being offered for the first year of the engagement and the range or average cost per hour of audit services.

ADDITIONAL DATA

Provide any additional data the proposer feels may be helpful in the selection process.

AUDIT PROPOSAL EVALUATION

PRIOR AUDITING EXPERIENCE (0-25)

Number of municipalities/libraries currently being audited by office which will handle audit (Consider governmental units similar in size) (15)

Other governmental experience (10)

REFERENCE RESPONSES (0-25)

Are they happy with firm?

Do they meet deadlines?

Is their staff knowledgeable in municipal accounting and auditing?

Do they have low staff turnover on your audit?

Is the audit partner involved?

QUALIFICATIONS (0-30)

Involvement in municipal activities – organizations, technical committees, etc. (15)

Municipal experience of staff assigned to audit (15)

PROPOSED FEE (0-20)

Lowest fee x20

Fee of specific firm

NOTE - The above suggested allocation of points should be modified based on items your library feels are most important